**BOSTON EDISON COMPANY**

**CAMBRIDGE ELECTRIC LIGHT COMPANY**

**COMMONWEALTH ELECTRIC COMPANY**

**NSTAR GAS COMPANY**

# Direct Testimony of Bernard B. Peloquin

**Exhibit NSTAR-BBP-1**

**D.T.E. 05-85**

**BOSTON EDISON COMPANY**

**CAMBRIDGE ELECTRIC LIGHT COMPANY**

**COMMONWEALTH ELECTRIC COMPANY**

**NSTAR GAS COMPANY**

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## I. INTRODUCTION

**Q. Please state your name and business address.**

A. My name is Bernard B. Peloquin. My business address is NSTAR, One NSTAR Way, Westwood, Massachusetts, 02090-9230.

**Q. By whom are you employed, and in what capacity?**

A. I am the Director of Total Compensation of NSTAR Gas and Electric Company, an affiliate of Boston Edison Company ("Boston Edison"), Commonwealth Electric Company ("Commonwealth"), Cambridge Electric Light Company ("Cambridge"), collectively "NSTAR Electric", and NSTAR Gas Company ("NSTAR Gas"; together with NSTAR Electric, the "Companies"). In this capacity, I am responsible for the development, implementation and administration of the compensation and employee benefits programs for the Companies.

**Q. Please describe other positions you have held at the Companies and your professional qualifications.**

A. Since 2000, I have served as the Director of Total Compensation for the Companies. I served as the Manager of Employee benefits for COM/Energy Services Company from 1993 to 1999. I have also served in a number of other positions at COM/Energy Services Company, including Senior Financial Analyst in the Treasury area and Financial Analyst in the Financial Reporting department. I received my undergraduate degree in business management from Boston University in 1982 and a Masters degree in Business Administration from Babson College in 1990. In addition, I received my Certificate in Pension and Employee Benefits Administration from Bentley College in 1995 and I am currently working to complete the certified financial planning program at Boston University.

**Q. Have you previously testified before the Department of Telecommunications and Energy?**

A. I have not had the opportunity to personally testify before the Department of Telecommunications and Energy (the “Department”) prior to this case. However, I have assisted in the preparation of many filings with the Department relating to long-term financings and Department docket number D.T.E. 03-47, which established a reconciliation adjustment mechanism for the recovery of costs associated with the Companies’ obligations to provide pension benefits and post-retirement benefits other than pensions (“PBOPs”) to their employees.

## II. PURPOSE AND ORGANIZATION OF TESTIMONY

**Q. What is the purpose of your testimony?**

A. I am testifying on behalf of the Companies on issues relating to employee wages, salaries and employee benefits. Specifically, my testimony provides support and comparative analysis for the Companies’: (1) represented employee wages;

(2) non-represented salaries and incentive compensation; and (3) employee benefits.

**Q. How is your testimony organized?**

A. My testimony is organized as follows:

- **Section III:** Department standards of review
- **Section IV:** The Companies' compensation philosophy
- **Section V:** Represented employee compensation
- **Section VI:** Non-represented employee compensation
- **Section VII:** Employee benefits for represented and non-represented employees
- **Section VIII:** Conformance with the Department's standards regarding compensation and comparative review of compensation and employee benefits.

## III. DEPARTMENT STANDARDS OF REVIEW

**Q. Please generally describe the Department's standard of review for considering compensation and employee benefits expenditures.**

A. Although I am not a lawyer, I have been advised that the Department's requirements with regard to compensation and employee benefits expenditures are that these programs must be reasonable when compared to other, similar investor-owned utilities. We believe that the Companies' compensation philosophy has resulted in a competitive compensation program that satisfies the Department standard for reasonableness.

Specifically, the Department's standard for wages associated with union payroll adjustments requires that three conditions be met: (1) the proposed increase must take effect before the midpoint of the first twelve months after the rate increase; (2) the proposed increase must be known and measurable, i.e., based on signed contracts between the union and the company; and (3) the company must demonstrate that the proposed increase is reasonable. Boston Gas Company d/b/a KeySpan Energy Delivery New England, D.T.E. 03-40, at 111 (2003); Massachusetts Electric Company, D.P.U. 95-40, at 20 (1995). To recover an increase in non-union wages above test-year levels, a company must demonstrate that: (1) there is an express commitment by management to grant the increase; (2) there is an historical correlation between union and non-union raises; and (3) the non-union increase is reasonable. D.T.E. 03-40, at 111; D.P.U. 95-40, at 21. Non-union salary increases that are scheduled to become effective no later than six months after the date of the Order may be included in rates. D.T.E. 03-40, at 111; Boston Edison Company, D.P.U. 85-266-A/271-A at 107 (1986).

With respect to incentive compensation plans, the Department determines whether the amounts to be included in the cost of service are: (1) reasonable in total; and (2) reasonably designed to encourage good employee performance. Massachusetts Electric Company, D.P.U. 89-194/195, at 34 (1989). In particular, the Department reviews incentive plans to ensure that they are, at least in part, tied to the performance of the individual employee and the provision of benefits to customers. Id.; D.T.E. 03-40, at 124.

In determining the reasonableness of a company's employee compensation expense, the Department reviews the company's overall employee compensation expense to ensure that its employee compensation decisions result in a minimization of unit-labor costs. D.T.E. 03-40, at 111; Boston Gas Company, D.P.U. 96-50 (Phase I) at 47. This approach ensures and recognizes that the different components (e.g., wages and benefits) are to some extent substitutes for each other, and that different combinations of these components may be used to attract and retain employees. However, the individual components of a company's employment compensation package are appropriately left to the discretion of a company's management. Cambridge Electric Light Company, D.P.U. 92-250, at 55 (1993).

To enable the Department to assess the reasonableness of a company's total employee compensation expense, companies are required to provide comparative analyses of their employee compensation expenses. D.T.E. 03-40, at 112. Both current and total compensation expense levels and proposed increases are examined in relation to other New England investor-owned utilities and to companies in a utility's service territory that compete for similarly-skilled employees. D.T.E. 03-40, at 112.

As described throughout my testimony and in the attached exhibits, the Companies' compensation programs satisfy the Department's standards.

## IV. THE COMPANIES' COMPENSATION PHILOSOPHY

**Q. What is the Companies' compensation philosophy?**

A. The Companies' compensation philosophy is to provide a level of compensation that is competitive with that of the utility industry and general industry employers. The Companies target the median base pay for represented and non-represented employees in order to balance the cost of salaries and wages with the need to attract and retain qualified employees. In addition, the Companies have incentive programs for non-represented employees to further motivate employees in advancing the Companies' goals in the areas of customer service, safety and productivity. The Companies also provide employee benefits programs that are competitive and commensurate with the offerings of the utility and general industry.

## V. REPRESENTED EMPLOYEE COMPENSATION

**Q. Please indicate the bargaining units representing the Companies' union employees.**

A. The Companies currently have contracts with two bargaining units. Approximately 1,900 employees are represented by Local 369 of the Utility Workers Union of America, AFL-CIO (Exhibit NSTAR-BBP-2), with a contract extending through June 1, 2009. Approximately 250 employees are represented by the Local 12004, United Steelworkers of America, AFL-CIO (Exhibit NSTAR-BBP-3). Their contract expires March 31, 2006.

**Q. How are compensation and employee benefits determined for represented employees?**

A. Wage rates and employee benefits are mandatory subjects of bargaining under the National Labor Relations Act. The Companies periodically engage in the collective bargaining process with union leadership to negotiate the terms of the compensation and employee benefit plans as well as other aspects of the employment for represented employees. Labor negotiations have become increasingly challenging for the Companies and other employers, as they have sought to contain compensation costs, while concurrently addressing a myriad of key concerns such as worker productivity, flexibility and the rising costs of employee benefits, especially in the areas of health care and pensions.

**Q. Please describe the Companies' preparation for the most recent negotiations with Local 369 of the Utility Workers Union of America.**

A. The negotiation process between the Companies and Local 369 began in early 2004 in preparation for the contract expiration on May 15, 2005. The Companies' key objectives for these negotiations can be summarized as follows:

- Obtain changes in work schedules, job specifications and practices that would enable the work force to be more effective and efficient in serving customers;
- Establish market-based wages; and
- Address increasing employee benefit costs, especially those relating to pension and health care while providing market-based benefits.

Also, in preparation for negotiations, the Companies engaged the services of Towers Perrin to benchmark the wage rates of their represented positions. This information was important in order to frame the range of wage increases that would potentially be available for bargaining purposes.

**Q. What was the outcome of these negotiations?**

A. Following more than a year of extensive negotiations, the Companies and Local 369 were unable to achieve a mutually acceptable result by the time the contract expired on May 15, 2005. Members of Local 369 voted to strike effective May 16, 2005. The parties continued to negotiate during the strike, and ultimately agreed to contract terms. The strike lasted approximately three weeks. Although the strike proved difficult for all of the Companies’ constituencies, the Companies achieved many of their bargaining objectives while providing market-based wages and employee benefits.

**Q. Have you had similar results in recent negotiations with Local 12004?**

A. The Companies' current contract with Local 12004 that expires in March 2006, provided wage adjustments of 4 percent in 2002 and 3 percent in each of the subsequent three contract years. This contract addressed many key business issues, including work practice changes to improve productivity and better serve customers, increased health care contributions and changes other welfare benefits. The Companies will seek further productivity improvements and standardization of employee benefit plans in contract negotiations with Local 12004.

**Q. Do you think that you achieved satisfactory wage settlements in your recent contract negotiations?**

A. The Companies believe that their contract settlements were reasonable when compared to recent contract agreements, especially in consideration of changes made to employee benefits programs. The changes in employee benefits plans are described in more detail in the Employee Benefits Section of this testimony.

## VI. NON-REPRESENTED EMPLOYEE COMPENSATION

**Q. Please describe the elements of cash compensation for the Companies' non-represented employees.**

A. The Companies provide two competitive compensation programs for exempt non-represented employees that support a pay-for-performance philosophy: base pay and incentive pay. The base pay program provides a framework for managing base salaries consistent with the market rate assigned to a job and in consideration of an employee's skill level, experience and performance. The incentive programs are designed to motivate and reward non-represented exempt employees who have contributed to the Companies' success in key performance areas.

**Q. Please describe the Companies' base pay program.**

A. The Companies' non-represented jobs are assigned a market rate in one of two ways. First, a benchmark job is a position found in other organizations with similar job content, responsibilities, career levels, skills and experience and for which significant competitive market data can be obtained. The market rate for a benchmark job represents the median salary at which incumbents in comparable jobs are paid. Second, a non-benchmark job, which does not have comparable external market data, is linked to the market rate of a benchmark job with similar responsibilities, skills and experience. Each market rate has a minimum and maximum level developed using a +/- 20 percent range around the market rate. Actual compensation is determined based on the job incumbent's ability, experience and performance.

**Q. How are market rates determined?**

A. Market rates are determined with the assistance of an external consultant using multiple published compensation survey studies shown in Exhibit NSTAR-BBP-4. The Companies have employed the services of Towers Perrin to conduct a market review of the Companies' non-represented positions. Towers Perrin, a premier provider of human resources consulting services, has an extensive employee compensation practice and access to market survey data relating both to the energy services industry and general industry.

**Q. Please describe the methodology used by Towers Perrin to review the Companies' market rates.**

A. Working with the Companies' human resources personnel, Towers Perrin selected positions representing the majority of non-represented employees of the Companies. In conducting this analysis, a job pricing strategy was developed to ensure that appropriate labor markets were used for comparative purposes, both from an industry and geographic perspective. Energy industry data was used for positions unique to the energy industry, while a blend of energy and general industry data was used for positions found in both energy and other industry sectors. Using 2004 salary data from established survey sources, pay data was aged to January 2005 utilizing an annual update factor of 3.5 percent, which is representative of recent annual salary movement.

**Q. What overall market rate of pay do the Companies seek to target for their non-represented employees?**

A. The Companies target the market median for their non-represented rates of pay. The Companies believe that this target represents a responsible balance between the Companies' obligation to provide energy services at a reasonable cost and the need to attract and retain qualified employees.

**Q. How does incentive compensation fit into the Companies' compensation package for non-represented employees?**

A. Cash incentive programs complement the Companies' base pay program and are designed to support the achievement of key business objectives such as customer service and satisfaction, system reliability and cost control. Incentive plan opportunities are available to exempt, non-represented employees. Award targets and payout ranges are based on job level and individual performance in achieving corporate, business area and individual performance. In addition, non-represented employees with strategic functions at the Companies, such as officers and certain directors, are eligible for awards under the Long-Term Incentive Plan. These awards are made in the form of NSTAR equity and vest over a three-year period.

**Q. How is employee performance measured in the incentive compensation plans?**

A. Annually, the Companies formulate strategic and operating objectives designed to continually improve service provided to our customers. During the test year, objectives deemed important to maximizing ratepayer benefits included: the reduction in operating and maintenance spending; improved electric and gas system reliability and performance; improved customer service; securing favorably priced and reliable energy; and the construction of a new 345 kilovolt transmission line to improve reliability and further reduce costs. Non-represented exempt employees are assigned performance goals designed to support the achievement of these objectives, as well as individual performance goals. Individual incentive awards are determined based on an assessment of the level of the performance goals(s) attained by the specific employee.

**Q. How does the base pay and incentive programs support the Companies' pay for performance approach to compensation?**

A. The base pay and cash incentive program are linked to the Companies' performance management process. This process begins each year with the establishment of an individual performance and development plan for each non-represented employee. The performance plans are tied to the Companies' business goals in areas such as customer service, safety, cost containment and process improvement. These performance and development plans are reviewed periodically with the employees by their supervisors throughout the year. At the end of the performance year, managers are given a budget for merit awards and for cash incentive awards. Merit awards are distributed to employees based on their individual performance, and their relative position to the market rate for their job. Based on internal guidelines, managers have the discretion to deliver higher-than-average merit awards for employees who meet or exceed their performance expectations. Similarly, if the Companies have succeeded in meeting their key performance objectives for the year, incentive payments are available to employees who have met their performance targets.

**Q. Have the Companies been successful in maintaining wage and incentive payments that are reasonable and in line with their compensation philosophy?**

A. Based on the most recent Towers Perrin review conducted for the 2004/2005 time frame, the Companies' base salary and total cash levels, including incentives, are aligned with the market median, pursuant to its compensation philosophy. Specifically, the Companies' base salaries were at 98 percent of the market median, and total cash levels were at 100 percent of the market median.

## VII. EMPLOYEE BENEFIT PLANS FOR REPRESENTED AND NON-REPRESENTED EMPLOYEES

**Q. Why do the Companies provide a comprehensive employee benefits program?**

A. The Companies provide health, welfare, defined benefit, defined contribution and other benefits as part of a comprehensive compensation package that is typical of benefits offerings by the utility industry and many companies in general industry. As was previously indicated, employee benefits for represented employees are determined through the collective-bargaining process.

**Q. What have the Companies done in order to address the cost of employee benefits?**

A. As a major component of the Companies' total compensation package, the design and cost of employee benefits plans have been an important focus of the Companies' management. Since the merger of BEC Energy and Commonwealth Energy System in 1999, the Companies have worked to standardize, streamline and reduce the cost of employee benefit plans for the Companies' employees, while maintaining a competitive package. In 1999, the Companies retained the services of Watson Wyatt Worldwide, a human resources consulting and actuarial firm, to assist with this process, evaluate the Companies' employee benefit programs and make recommendations for consolidation offerings. Based on Watson Wyatt's recommendations, the Companies began the process of changing employee benefit plan offerings for non-represented employees. Some of the key changes made by the Companies at that time are as follows:

- Standardized medical plan offerings, eliminated high-cost indemnity plans and increased employee payroll contributions to health plan costs;
- Standardized the dental plan offering and increased employee contributions to dental plan costs;
- Standardized basic life insurance plans at two times base pay, eliminated additional company paid survivor income life insurance coverage and added employee-paid supplemental life insurance coverages;
- Standardized the defined contribution plan and reduced the employer match a match of 50 percent on up to 8 percent of eligible pay from a dollar-for-dollar match of up to 6 percent of eligible pay;
- Converted the traditional final average pay defined benefit plan to a pension equity plan with a 525 percent cap on pension credits for

employees hired as of August 1999. Employees hired after that date would be eligible for up to 325 percent pension credits;

- Applied a company medical cost contribution cap for all new pre-65 retirees and introduced post-employment contributions and Medicare HMO's for retirees age 65 and older;
- Standardized post-employment life insurance coverage; and
- Capped vacation accrual at five weeks for employees and froze future vacation accruals for employees eligible for more that five weeks of vacation.

**Q. Have the employee benefit plans of union employees been standardized as well?**

A. The Companies' employee benefit plan strategy was to standardize employee benefit plans and reduce costs for both represented and non-represented employees. In doing so, the Companies have sought to provide comparable employee benefits for all employees. The Companies have made progress in meeting this standardization goal. At the time of negotiations with Local 369 in 2000 (along with five other bargaining units that had merged into Local 369 at that time), the Companies successfully negotiated most of the changes that were adopted for non-represented employees with certain exceptions including the hybrid defined benefit plan, and the methodology to calculate the company post-employment contributions for health care and post-employment life insurance. The Companies have also successfully negotiated many of the non-represented employee benefit changes with Local 12004 in 2002.

**Q. Have the Companies made any changes to reduce post-employment benefit costs for existing retirees?**

A. Effective April 1, 2003, the Companies began to standardize the post-retirement benefits of existing retirees, resulting in significant cost savings. At the same time, retirees maintained important medical and prescription drug insurance coverage at levels comparable to current employees. The changes to existing retirees were as follows:

- Eliminated the Master Medical Indemnity plan for pre-65 retirees;
- Standardized the Medex II plan for all retirees age 65 and older and eliminated the more costly Medex III plan;
- Instituted mandatory mail order for maintenance drugs to reduce cost;
- Eliminated Medicare Part B reimbursement for all existing retirees and their dependents;
- Eliminated dental plan eligibility for any retiree who was not already age 65 and receiving such benefit as of April 1, 2003; and
- Eliminated vision plan coverage for retirees age 65 and over.

**Q. Please describe the Companies' strategy to address the cost of quality health care.**

A. Although the cost of quality health care is a national business and social problem, the Companies believe that there are several appropriate steps that can be taken to contain costs for customers while maintaining high quality coverage for employees and retirees. In 2003, the Companies developed a health care strategy to address this problem. The key components of this strategy are summarized as follows:

- Understand drivers relating to health care costs;
- Target wellness and disease management initiatives to health care conditions;
- Implement health care plans that encourage consumerism and advantaged payment strategies; and
- Improve employee awareness and participation in health care issues through better communication.

**Q. What have the Companies done to implement this strategy?**

A. The Companies have made substantial progress in implementing this health care strategy. By analyzing claims data provided by their health plan administrators, the Companies have been able to determine certain health conditions that contribute to health care costs. The Companies have targeted their health and wellness programs and partnered with health plans to extend disease management programs. In 2004, approximately one-half of the Companies' employees participated in a company-sponsored wellness program that includes health fairs, screenings, fitness programs and smoking cessation classes, as shown in Exhibit NSTAR-BBP-5. In 2005, the Companies offered a consumer driven health plan to non-represented employees and successfully negotiated extending this plan along with a tax-advantaged Health Spending Account to employees represented by Local 369 for 2006. This plan will be offered at a lower employee contribution rate, but will maintain relatively high deductibles and co-payment costs. At the same time, this plan will offer comprehensive preventative care to encourage early treatment in order to avoid more expensive claims. In order to improve employee awareness and participation in health care issues, as well as to educate employees regarding other employee benefits and safety issues, the Companies launched an internal communications vehicle, the "Health, Benefits and Safety Newsletter." In addition, the Companies have subscribed to an external publication, the "Top Health" newsletter. Both of these publications, as shown in Exhibit NSTAR-BBP-6, are sent to employees' homes in order to reach out to dependents who represent a large constituency covered by the Companies' health and benefit plans.

**Q. What has been the impact on the Companies' health care costs?**

A. Although it is relatively early to tell, the Companies believe that this strategy will help to contain the growth of health care expenditures and will nurture a culture of wellness over the long term.

**Q. What other measures do the Companies employ to ensure the competitiveness of employee benefit costs?**

A. Because the cost of employee benefits are a substantial cost of service, the Companies closely monitor costs and utilize the services of third-party experts to assist in the renewal and bidding processes. For example, on an annual basis, the Companies evaluate the health care renewals with the help of health care consultants to evaluate the renewal proposals of insurers and determine if proposals are competitive and if administrative charges are reasonable. The Companies used a competitive bidding process to select a defined contribution plan administrator upon the merging of Commonwealth Energy System and BEC Energy. The Companies recently competitively bid their group life insurance program to obtain the lowest cost possible for this program. We believe that these measures have been effective in maintaining reasonable costs and effective service for the Companies' employee benefits program.

## VIII. COMPLIANCE WITH DEPARTMENT STANDARDS

**Q. What are the Department standards with regard to justifying the reasonableness of compensation and employee benefit costs?**

A. As I mentioned above, the Department requires compensation and employee benefits expenditures to be reasonable when compared to other investor-owned utilities. Indeed, the Companies' compensation philosophy has resulted in a competitive compensation program that satisfies the Department standard for reasonableness and, therefore, meets this standard.

As described above, the Department's standard for union payroll adjustments requires that three conditions be met: (1) the proposed increase must take effect before the midpoint of the first twelve months after the rate increase; (2) the proposed increase must be known and measurable, i.e., based on signed contracts between the union and the company; and (3) the company must demonstrate that the proposed increase is reasonable.

To recover an increase in non-union wages, a company must demonstrate that: (1) there is an express commitment by management to grant the increase; (2) there is an historical correlation between union and non-union raises; and (3) the non-union increase is reasonable. Non-union salary increases that are scheduled to become effective no later than six months after the date of the Order may be included in rates.

Also, in relation to amounts paid through incentive compensation plans, they must be reasonable in aggregate and be designed to motivate good employee performance. The criteria used in such plans must be tied to performance of the individual employee and be directed to providing benefits to customers.

As described in more detail below, the Companies' compensation programs satisfy the Department's standards.

**Q. Have the Companies performed a comparative analysis to demonstrate the reasonableness of their total cash compensation levels?**

A. Comparative analyses that examined the Companies' base salary and total cash compensation levels were prepared with the assistance of Towers Perrin. The Companies compared their compensation levels with other investor-owned utilities in the northeastern states of Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island and Vermont, as well as general industry companies in the Boston Area. These represent the markets in which the Companies compete for similarly-skilled employees. The analyses indicate that the Companies' total compensation levels are reasonable when compared with other northeast utilities and Boston employers.

**Q. What source materials were relied upon when preparing these analyses?**

A. Towers Perrin used several compensation surveys that provide summary job descriptions, have a variety of job levels in multiple functional areas and have clearly-defined data elements such as base salary, bonus, and total cash. Each of the surveys used in these analyses is a professionally recognized survey source. Annually, the Companies ask Towers Perrin to conduct analyses using these survey sources in order to establish and maintain a market-driven base pay program.

**Q. How was the comparative analysis conducted?**

A. Towers Perrin was asked to take a snapshot of the market as of the midway point of the test year, or January 1, 2005. The Companies provided Towers with the base salary and total cash compensation for the Companies' employees. Total cash compensation reflects base pay combined with any annual cash award paid through an incentive or bonus program. Because the compensation surveys reflected data as of the spring of 2004, Towers updated the survey data to January 1, 2005 using a 3.5 percent annual factor, which is a common and accepted compensation practice. Towers matched the Companies' positions to survey jobs having comparable responsibilities and collected market data at the market median, which is the midpoint of the market. The Companies strive to align their base pay and total cash compensation to the market median.

**Q. What did the comparative analysis show for the Companies represented positions?**

A. The Companies compared their union positions to those generally found within other publicly owned utility companies, as is shown in Exhibit NSTAR-BBP-7. In terms of base pay and total cash compensation, the Companies are close to the median of the compensation paid by other northeast utility companies with a relationship to market of 3.2 percent and 3.1 percent respectively.

**Q. When comparing the compensation for the Companies' non-represented positions to the market, what did the comparative analysis show?**

A. The comparative analysis was divided into two parts. Exhibit NSTAR-BBP-8 presents the Companies' positions performing work that can be found within other Boston area companies. This exhibit indicates that, for both base pay and total cash compensation, the Companies are close to the median of the Boston Area with a relationship to market of 4.3 percent and 1.5 percent respectively. Exhibit NSTAR-BBP-9 presents positions performing work generally found within other publicly owned utility companies. In terms of base pay and total cash compensation, the Companies are very close to the median compensation paid by other northeast utility companies with a relationship to market of 1.4 percent and 0.1 percent respectively.

**Q. Have the Companies granted base salary increases to the represented and non-represented work forces during the past few years and how do they compare to the external marketplace?**

A. Yes, the Companies have provided base salary increases to their employees during the past few years. Base salary increases awarded to represented employees are determined by negotiated-contract agreements. Exhibit NSTAR-BBP-10 reflects the ten-year history of general wage increases for represented employees both prior to and after the merger of Commonwealth Energy System and Boston Edison. Exhibit NSTAR-BBP-11 displays general wage increases provided to represented employees by other utilities within New England. A comparison of Exhibits NSTAR-BBP-10 and NSTAR-BBP-11 indicates that the general wage increases provided to the Companies' represented employees are comparable to represented employees in other New England companies.

Base salary awards for non-represented employees are generally provided through merit budgets, which are developed based on market conditions and internal equity considerations. Exhibit NSTAR-BBP-12 reflects the ten-year history of merit awards provided to non-represented employees both prior to and after the merger of Commonwealth Energy System and BEC Energy. Exhibit NSTAR-BBP-13 represents a compilation of merit increase award studies conducted by leading human resources consulting firms. The studies reflect the actual 2004 increases provided and projected 2005 awards to be given to non-represented employees (see

Management and Exempt data). The studies indicated that, on a national, regional and utility industry basis, the merit awards provided to the Companies' non-represented employees have been slightly less than other non-represented employees.

Finally, Exhibit NSTAR-BBP-14 demonstrates that over the past ten years the general wage increases provided to represented employees are comparable to the merit increases awarded to non-represented employees.

**Q. Is there an express commitment to provide non-represented employees a general wage increase during the period following the Department's decision in this proceeding?**

A. Yes, there is. As shown in Exhibit NSTAR-BBP-15, management has formalized its plans to institute a wage increase for non-represented management employees effective May 2006. This wage increase represents an approximate 3 percent increase over the wage levels experienced during the test year.

**Q. Could you discuss the Company's incentive plans and their compliance with the Department's standards?**

A. As previously discussed, incentive plan objectives are reviewed at the beginning of each year to ensure that they are designed to promote improved customer service and provide safe, reliable and cost-effective service to customers. Employees participating in the plans are assigned performance goals that support key strategic and operating objectives, as well as individual performance goals. Potential awards are aligned with those of other electric and gas utility companies. Actual individual incentive awards are provided only after it has been determined the Companies have successfully achieved their strategic and operating objectives and only to the extent individual performance goals have been obtained. It is our belief the awards provided during the test year reflected safe, reliable and cost-effective service to our customers and were reasonable.

**Q. What figures have been used in the cost-of-service study for compensation levels for represented and non-represented employees?**

A. As explained in Ms. Vaughan's testimony, in accordance with Department precedent, the Companies' overall compensation and benefits expenses are reasonable, based on appropriate comparative analyses. Consistent with that overall compensation package, the union wage increases constitute known and measurable increases based on signed contracts with the two unions that represent employees of the Companies. Wage increases have been determined under the terms of those contracts. The total figure for union compensation used in the Companies' calculation of their respective revenue requirements is based on the percent increases mandated by the contracts and is computed in the exhibits attached to Ms. Vaughan's testimony. This figure represents the wage expenses incurred during the test year, adjusted for the union wage increase to take effect before the midpoint of the first 12 months following the Department's decision in this proceeding.

Non-union labor increases are calculated in identical fashion to that for the union employees. Department precedent allows post-test-year increases that will occur within six months after the date that new rates go into effect if it finds that there is an express commitment by management to grant the increase and that there is an historical correlation between union and non-union pay increases. In accordance with this precedent, the total figure for non-union compensation used in the Companies' calculation of their respective revenue requirements is based on the percent increases for non-union labor and are computed in the exhibits attached to Ms. Vaughan's testimony.

**Q. Please describe the historical wage parity between union and non-union employees within the Companies.**

A. As I mentioned above, Exhibit NSTAR-BBP-14 shows that, over an extended period of time, the level of annual wage increases for union and non-union employees has been comparable.

**Q. What approach did the Companies utilize to benchmark employee benefits programs?**

A. In order to measure the reasonableness of employee benefit programs, the Companies utilized Towers Perrin's BENVAL software, an actuarial program that provides a quantitative evaluation of benefits provisions and assists in the comparison of benefit programs against those of utility companies. The Companies compared their employee benefit programs to 18 investor-owned utility companies from the northeastern states including Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island and Vermont, all of which participate in the BENVAL survey. The employee benefits programs of the Companies' non-represented and represented employees were compared with those of respective non-represented and represented employees.

**Q. What were the results of this benchmark analysis?**

A. Overall, the value of the Companies' employee benefit programs is reasonable when compared to those of the utility group. As summarized in Exhibit NSTAR-BBP-16, the Companies' represented program values are within the utility group range in most categories. The Companies' combined represented employee benefit program value, reflecting the recently negotiated contract with Local 369 is 103.8 percent of the average value and is well within the utility group range of 86.3 percent to 115.9 percent. Similarly, as summarized in Exhibit NSTAR-BBP-17, the Companies' non-represented program values are within the utility group range in most employee benefit categories. The Companies' combined non-represented employee benefit program value is 108.2 percent of the average value and is well within the utility group that ranges from 84.6 percent to 126.1 percent. Given the large differences in the comparison group that range from rural utilities to metropolitan utilities, the Companies' program values are reasonable and within the range of the group average. In addition, as I previously described in my testimony, the Companies have made extensive changes in their benefit programs affecting all employee and retiree constituencies that will help to contain the costs of employee benefits in the coming years.

**Q. Did you compare the Companies' employee benefit programs with general industry?**

A. Yes, we did. Although general industry employee benefits programs often differ from the utility industry, the Companies did utilize the Towers Perrin's BENVAL software to compare non-represented employee benefit programs. The Companies reviewed approximately 160 employers from a broad range of industries including manufacturing, retail, services, communications, health care, financial services and other industries, but excluding utility companies. These companies are also located in the northeastern states identified above. As is shown on Exhibit NSTAR-BBP-18, the Companies' non-represented employee benefit programs is shown as a percent of the median company or the 50th percentile that is valued at 100 percent. In addition, the 25th and 75th percentile values are shown for comparative purposes. Overall, the Companies' non-represented employee benefit program value is 110.0 percent of the median. Like most utility companies, the Companies continue to offer defined benefit pension plans, post-retirement health plans and post-retirement death benefits. Conversely, due to the business strategies of many companies in general industry, these types of employee benefits programs are not part of their total compensation programs. The absence of such programs for many companies in general industry is shown as 0.0 percent values under the General Industry 25th percentile column for these benefits. At the same time, the average general industry employers had more generous defined contribution plans reflecting different recruiting and retention strategies. The Companies' defined contribution plan is 76.7 percent of the median value of the general industry group or between the 25th and 50th percentiles.

**Q. Do you think it is reasonable to sponsor defined benefit plans, post-retirement health plans and post-retirement death benefits?**

A. Yes, I do. In the utility industry, the retention of skilled and knowledgeable employees is critical to the operation and maintenance of the Companies' electric and gas infrastructure and providing effective customer service. A thorough understanding of the electric, gas and customer service systems requires a substantial investment in training and development over a period of many years. The Companies' sponsorship of these employee benefit programs is an important part of the total compensation program that is designed to attract and retain these employees who are skilled in operating the Companies' system. It is very important to note that defined benefit pension plans, post-retirement health plans and post-retirement death benefits are offered as part of the compensation package by most utility company employees, as is shown in the comparisons. At the same time, while these benefits are important components of the Companies' total compensation package, the Companies have worked to reduce the cost of these benefits by implementing a lower value pension equity defined benefit plan, by making reductions in post-retirement health care benefits for all current and future retirees and by reducing post-retirement death benefits.

**Q. Does this conclude your testimony?**

A. Yes, it does.